

University of Arkansas, Fayetteville
ScholarWorks@UARK

Annual of the Arkansas Natural Resources Law
Institute

School of Law

2-2010

Recent Developments in Natural Resources Law - 2010 Update

Thomas A. Daily

Follow this and additional works at: <http://scholarworks.uark.edu/anrlaw>

Recommended Citation

Daily, Thomas A., "Recent Developments in Natural Resources Law - 2010 Update" (2010). *Annual of the Arkansas Natural Resources Law Institute*. Paper 84.
<http://scholarworks.uark.edu/anrlaw/84>

This Article is brought to you for free and open access by the School of Law at ScholarWorks@UARK. It has been accepted for inclusion in Annual of the Arkansas Natural Resources Law Institute by an authorized administrator of ScholarWorks@UARK. For more information, please contact scholar@uark.edu.

RECENT DEVELOPMENTS IN NATURAL RESOURCES LAW–2010 UPDATE
By Thomas A. Daily¹

Believe it or not, it's time for this again. There is a problem with time enjoyed—gone before you realize. 2009 was an interesting and busy year, as you will see. Here is what happened in Arkansas Natural Resources Law, with just a couple of important notes from other jurisdictions. For those of us with baby boomer eyes, I have broken with Bluebook and bolded the names of the new stuff.

RECENT LEGISLATION

The 2009 session of the Arkansas General Assembly came and went with its usual offering of scary bills. As is typical, we saw proposals to terminate “dormant” mineral interests, severely restrict surface operations, deny eminent domain power to developers of gas gathering systems, make garbage of ownership of minerals under lands subject to contracts of sale—all the usual stuff that our citizen legislators feel they need to offer up, in order to pander to folks back home. Fortunately, none became law. Those few bills which did become acts are these:

Act No. 719 of 2009² defines the “prudent operator” standard under an oil and gas lease. The act expressly states that a lessee/working interest owner is not a fiduciary. The owner does owe an obligation to perform the “covenants of the lease”³ in good faith and to develop the leased mineral estate as a prudent operator for the parties’ mutual benefit. That is pretty much what I thought the law already was, before someone went to all this trouble in the legislature. Apparently, its backers were

¹Member, Daily & Woods, P.L.L.C., Fort Smith, Arkansas.

²Now codified as A.C.A. § 15-73-207.

³Including, it is assumed, implied lease covenants.

spooked by some of the loose language within the Supreme Court's opinion in *SEECO, Inc. v. Hales*.⁴ If that is true, they are just scratching the surface. That opinion has enough loose language to justify its own special session.

Act No. 1183 of 2009⁵ requires that an oil and gas lessor be given notice of the first assignment of his lease, if the assignment occurs within 24 months after the lease's execution. It applies, prospectively, only to leases entered into after August 1, 2009. The notice is required to contain the name, address and contact information for the "buyer"⁶ of the lease and must be sent by first class United States mail. No sanctions for failure to comply are contained within the act.

Act No. 421 of 2009⁷ is my personal favorite of all of the 2009 Legislature's work. That act sets the ad valorem tax value of a non-producing mineral interest at "zero (0) value."⁸ The purpose of this much-needed piece of legislation is to cure an obvious illegality in the ad valorem taxation of mineral interests. Previously, many counties attempted, however clumsily, to tax non-producing mineral interests when severed from the surface, but never thought to increase the assessment of a tract with unsevered minerals to reflect the additional value attributable to its unsevered mineral interest. That was a clear violation of the requirement of Article 16, Section 5 of the

⁴341 Ark. 673, 22 S.W.3d 157 (2000).

⁵Now codified as A.C.A. § 15-73-208.

⁶Presumably the first assignee.

⁷Now codified as part of A.C.A. § 26-26-1110.

⁸My apologies for this footnote. I am always amused by the Legislature's apparent need to clarify the meaning of a prime number or, in this case, non-number.

Arkansas Constitution:

(a) All real and tangible personal property subject to taxation shall be taxed according to its value, that value to be ascertained in such manner as the General Assembly shall direct, making the same equal and uniform throughout the State. No one species of property for which a tax may be collected shall be taxed higher than another species of property of equal value, except as provided and authorized in Section 15 of this Article, and except as authorized in Section 14 of this Article. The General Assembly, upon the approval thereof by a vote of not less than three-fourths (3/4ths)⁹ of the members elected to each house, may establish the methods and procedures for valuation of property for taxation purposes, but may not alter the method of valuation set forth in Section 15 of this Article.

(b) The following property shall be exempt from taxation: public property used exclusively for public purposes; churches used as such; cemeteries used exclusively as such; school buildings and apparatus; libraries and grounds used exclusively for school purposes; and buildings and grounds and materials used exclusively for public charity. Nothing in this Section shall affect or repeal the provision of Amendment 57 to the Constitution of the State of Arkansas pertaining to intangible personal property. [Added by Const. Amend. 59.]

The change is clearly for the good. The only question is whether the Legislature may constitutionally do what it has done. Sadly, the property tax is hard-coded into this state's constitution. I have confirmed that the act received the 3/4 vote required by Section (a) above. The only question is whether it is really a "method and procedure" rather than an exemption, which can only be accomplished by constitutional amendment to Section (b). I, for one,¹⁰ do not intend to complain.

Act No. 1175 of 2009 was an Oil and Gas Commission sponsored bill which made numerous technical changes to Arkansas' oil and gas statutes. Its most notable sections are Section 1, which clarified that five affirmative votes are required for the

⁹/d., as to a simple Fourth (4th) Grade fraction.

¹⁰(1).

Commission to issue an order, and Sections 15 and 17 which amended A.C.A. § 15-72-304 and A.C.A. § 15-74-604, respectively, to permit royalty or other proceeds of production to accumulate up to \$100 before requiring payment. These latter sections bring the amended statutes into conformance with A.C.A. § 15-74-601(b)(2), which was similarly amended by Act No. 276 of 2003. Apparently whoever authored the 2003 legislation failed to realize that the minimum payment requirement appears in three separate code sections.

A similar act is **Act No. 389 of 2009**¹¹ which reduces the qualifying age of an oil and gas commissioner from 30 to 21 and requires that a majority of those¹² be persons “experienced in development, production or transportation of oil or gas.” That simple little bill, suggested because the previous law had not been revised when the Commission was expanded from seven to nine members, caused more controversy, both in and out of industry, than the rest of the oil and gas bills, good ones and bad, combined.¹³

Finally, **Act No. 452 of 2009**¹⁴ transferred certain authority to enforce the Federal Natural Gas Pipeline Safety Act of 1968 from the Arkansas Public Service Commission to the Oil and Gas Commission. The Oil and Gas Commission gained jurisdiction over pipelines whose owners are either gas production companies or their affiliates and are

¹¹Amending A.C.A. § 15-71-102-(b).

¹²The previous version said “four.”

¹³Go figure.

¹⁴Amending A.C.A. § 15-71-110-(d)(18).

neither gas public utilities nor affiliates thereof.

RECENT CASES

The Fayetteville Shale Play covers several central Arkansas counties which lack the long history of oil and gas production which exists in the ArkLaTex region in southwest and the Arkoma Basin in west central Arkansas. It was inevitable, then, that legal issues, long thought resolved in those traditional producing areas, would be litigated anew, if for no other reason than to convince a whole new bunch of lawyers what the law is.

It is only natural that we are seeing a raft of *Strohacker* tests. For anyone who may not remember, *Missouri Pacific Railroad Company v. Strohacker*,¹⁵ and other *Strohacker* cases which followed,¹⁶ deal with the legal meaning of the word “mineral(s)” when used in a grant or reservation, without specifying which mineral(s) are granted or reserved. Most, but not all, of these cases involve oil and gas’ inclusion into the definition of “mineral(s),” as used in early conveyances out of Arkansas’ land-grant railroads. *Strohacker* tests whether the substance at issue was within the contemplation of legal and commercial usage at the time and place of the grant or reservation involved in the current litigation. It differs from the more mainstream

¹⁵202 Ark. 645, 152 S.W.2d 557 (1941).

¹⁶The best compilation and explanation of these cases ever written is in Gerald De Lung’s article, **The Strohacker Doctrine—An Arkansas Rule of Property**, which was presented at the 1975 version of this institute and was then published in the July 1975 issue of **Arkansas Lawyer** magazine.

“Natural Meaning” test utilized in Texas¹⁷ in that the local test of *Strohacker* is as of the time of the grant or reservation, rather than the time of trial.

Thus, since *Strohacker* and its progeny require a county-by-county inquiry as to the approximate date those legal and commercial folks listed oil and gas among “minerals,” it makes perfect sense that the shale play has spawned a whole new round of *Strohacker* litigation. Still, the current crop of *Strohacker* cases look a little bit off-the-wall. Rather than revolving around the time period, 1890-1910, they involve reservations in deeds executed in the 1930's. Further, either I or counsel for the surface owners in the current cases woefully misunderstand *Strohacker*. Those counsel seem focused upon the fact that oil and gas **were not commercially produced** in central Arkansas in the 1930's. Therefore, they leap to conclude that reservations which did not name oil and gas, by name, did not include them.

I believe that reasoning is faulty. *Strohacker's* test has little or nothing to do with production.¹⁸ Rather, the question is: When did those thinkers whose thinking counts, those legal and commercial folks, begin to conjure oil and gas in their mental picture of a mineral buffet line?

Oil and gas were discovered in this country before the Civil War. They were first produced and consumed in parts of Arkansas, though minimally, before 1900. *Strohacker*, itself, was decided in 1941. By the 1930's there was a well-established oil

¹⁷See *Moser v. United States Steel, Corp.* 27 Tex. Sup. J. 473, 676 S.W.2d 99 (1984).

¹⁸Production only matters to the extent it affected “legal and commercial” understanding of the term “mineral(s).”

and gas industry both in South Arkansas and immediately west of the counties now at issue. Further, unlike the older reservations considered in the early *Strohacker* opinions, the deeds in these new cases reserved the right to “drill” for the reserved “mineral(s).”

At least three of the new cases found venue in United States District Court. The first two decided, ***Webco, Inc. et. al. v. Anadarko Petroleum Corporation***,¹⁹ and ***Usery v. Anadarko Petroleum Corporation***,²⁰ decided by District Judges G. Thomas Eisele and William R. Wilson, respectively, resulted in summary judgment for the severed mineral owner, Anadarko, which now owns most of the railroads’ reserved minerals.²¹ Those two district judges were persuaded by the records in their respective cases that, by the 1930's, the word about oil and gas was out, across all of Arkansas. Indeed, they found that to be a fact not subject to dispute.

The third federal case is pending before Judge Holmes. It is ***Robertson v. Union Pacific Railroad Company***,²² which involves a 1934 Jackson County reservation. Judge Holmes has split, somewhat, from Judges Eisele and Wilson. He denied summary judgment, advancing the case for a trial upon its facts. I predict the end result will be the same, though it will take longer.

¹⁹E.D. Ark. No. 4:07CV00035 (GTE).

²⁰E.D. Ark. No. 4:07CV01185 (WRW).

²¹The reservation in *Webco* was in a 1938 deed in Faulkner County; the *Usery* reservation was in a 1933 deed in White County.

²²E.D. Ark. No. 1:09CV00020 (JLH).

The real test case is pending in state court in the form of ***Froud v. Anadarko***,²³ a case filed in White County which now has a pending motion for class certification. *Froud* will almost certainly result in an appeal to the Supreme Court. That court's opinion will likely answer most, perhaps all, of these new questions.

Remember my comment earlier about teaching some law to those in the shale counties. That remark is not limited to lawyers. Some of the judges might benefit from refresher courses, as well. DeSoto Gathering Company is Southwestern Energy Company's pipeline subsidiary. As such, DeSoto has the power of eminent domain, but it did not exercise that right when it laid a pipeline across land in White County belonging to Richard and Shirley Chandler, and subject to a surface lease in favor of Janice Smallwood. In this instance DeSoto was operating under both rights granted by and oil and gas lease and an express easement, both granted by the Chandlers.

The Chandler/Smallwood surface lease was remarkably detailed. Ms. Smallwood got only the right to use ten acres²⁴ as a single-family residence for life or until she abandoned the property. Wisely, the Chandlers expressly reserved the power to "encumber" the property.

Subsequently, the Chandlers leased to Chesapeake Exploration, LLC. A well was then drilled, and the Chandlers granted a pipeline right of way to DeSoto, which laid the pipeline.

Ms. Smallwood claimed deliberate trespass to her rights as a surface tenant.

²³White County Circuit Court Case No. 2009-19-1.

²⁴The entire Chandler tract contained sixty acres.

She sued and obtained an injunction from the circuit court,²⁵ who ultimately commanded DeSoto to remove its pipeline. Ms. Smallwood was also awarded damages of nearly \$52,000,²⁶ plus costs.

On direct appeal to the Arkansas Supreme Court, in ***DeSoto Gathering Company v. Smallwood***,²⁷ justice, though delayed, was served. The court found the trial court had abused its discretion, reversed the judgment and remanded with instructions to dissolve the injunction.

The opinion, by Justice Corbin, is well written. It clearly distinguishes between the surface leasehold right of Ms. Smallwood and the retained rights, including the mineral estate and right to encumber of the Chandlers. DeSoto's activities, being authorized by persons with the legal power to so authorize, could not be a trespass.

The Fayetteville Shale Play set off an unprecedented leasing boom throughout much of the eastern half of the state, including in a number of counties which, in retrospect, did not deserve the attention. Two of our recent cases came from two such counties. The first of those is ***Frein v. Windsor Weeping Mary, LP***,²⁸ which involved a lease which should never have been taken. In 2005 Windsor Weeping Mary decided to lease a 7,000 acre tract in Lee County from the Frein family. Moreover, in a letter agreement, Windsor Weeping Mary promised to drill a minimum of two wells of

²⁵Hon. Bill Mills.

²⁶The trial court tripled her claimed actual damages.

²⁷2010 Ark. 5, ____ S.W.3d ____ (2010).

²⁸2009 Ark. App. 774, ____ S.W.3d ____ (2009).

sufficient depth to test the Fayetteville Shale Formation, within 18 months after the lease date. The lease did contain the standard language permitting the lessee to execute a release at any time.

When Windsor Weeping Mary realized that Lee County was not real prospective, it requested an extension of the 18 month drilling requirement. The Freins refused, so Windsor Weeping Mary executed and recorded a release of the lease.

The Freins sued, claiming breach of the letter agreement and unjust enrichment. Both the circuit court and Arkansas Court of Appeals held for Windsor Weeping Mary. The ruling was that the power to release the lease was not inconsistent with the drilling requirement of the letter agreement. Therefore, Windsor Weeping Mary could cut its losses and escape future liability. The court also held that, contrary to the Freins' contentions, Windsor Weeping Mary had not been unjustly enriched at Frein expense.

Wade A. Whistle, Attorney in Fact for Margaret Whistle Morris v. David H. Arrington Oil & Gas, Inc.²⁹ involves attempted leasing, by Arrington, in Phillips County, another place far from the real shale play. Arrington secured the Whistle lease, gave a time draft for \$232,200, and then decided that Phillips County was not a good place to be drilling. When Whistle presented the draft, dishonor occurred.

In the resulting litigation Arrington argued that its right to approve title as a condition of payment was at its sole discretion and, also, that Whistle's title was faulty because the power-of-attorney under which he acted did not authorize execution of an oil and gas lease. The second of those arguments may be the best, though Arrington

²⁹E. D. Ark No. 2:08CV00037 (BSM).

did not establish that the actual reason for dishonor of the Whistle drafts had anything to do with the quality of Whistle's title.

Judge Miller granted summary judgment to Whistle, suggesting a holding that the power to approve title within a draft demands an objective, rather than subjective, test of the lessor's title. Judge Miller slighted Arrington's second argument, finding that Mrs. Morris had later ratified the power-of-attorney, though that occurred after the fact.

Arrington continues to argue that the summary judgment should be withdrawn. It also contends that the decision is contrary to that of Judge Wright in *Falwell v.*

*American Shale Resources, L.L.C.*³⁰ In that case Judge Wright voided the lease given by Falwell Family Partnership to American Shale when American Shale's draft was not timely paid.

The most recent twist on the draft issue came February 19, 2010, in the case of *Trenthem v. David H. Arrington Oil & Gas, Inc.*³¹ The facts are eerily similar to those of the *Whistle* case, just discussed, though *Trenthem* happened in Cleburne County, where, at least, there is gas. The other difference is that Arrington won the *Trenthem* case. It was granted summary judgement by Judge Holmes who ruled that Arrington's dishonor of the plaintiffs' drafts was allowed, under the circumstances.

There is a distinction between *Whistle* and *Trenthem*, which explains the seemingly opposite results. Unlike the situation in *Whistle*, Arrington was able to show, in *Trenthem*, that it became nervous about the Plaintiffs' title after issuing the drafts

³⁰W. D. Ark. No. 4:06CV00609 (SWW).

³¹W. D. Ark. No. 1:09CV00017 (JLH).

and before acceptance was due. The Plaintiffs did not dispute that nervousness. Rather, they relied upon proof that their title was objectively marketable.

According to Arrington and Judge Holmes, marketability is not the issue. Judge Holmes ruled that Arrington had a right to dishonor based upon disapproval of title, regardless of that title's "marketability," as long as the dishonor was not in bad faith or fraudulent.

Surface owners in the Fayetteville Shale area absolutely refuse to believe that the "Limited Warranty Deeds" which they get, nearly for free, from Arkansas' Land Commissioner are worthless, though that is nearly always the case. Surface owners have been the only persons entitled to buy these worthless tax deeds since 2003.³² For about ten years prior to that, the state was required to keep tax-forfeited severed mineral interests as a state asset.³³ Before 1993, purportedly forfeited severed mineral interests were auctioned off at public sale, like any other real property interest.³⁴

The tax deed involved in *Selrahc Limited Partnership v. SEECO, Inc., et. al.*³⁵ was issued in 1973, long before surface owners were given their arguably unconstitutional preference.³⁶ It involved substantial acreage in several sections in

³²Acts No. 4490-92 of 2003.

³³Acts No. 2458-50 of 1993.

³⁴See Sadler, Drew, **Mineral Rights? The Constitutional Deficiency of Section 26-37-314 of the Arkansas Code**, 62 Ark. Law. Rev. 611, for an interesting discussion of two of the many constitutional problems with these tax sales.

³⁵2009 Ark. App. 865, ____ S.W.3d ____ (2009).

³⁶*Id.*

Van Buren County, Arkansas. Selrahc,³⁷ a limited partnership managed by Charles Roye, and the other appellant, Katrina Roye Peevyhouse, later acquired the purportedly forfeited interests by deed. Finding that no mineral producer was willing to pay them for a lease on their alleged interest, Selrahc and Ms. Peevyhouse brought suit, seeking to quiet their title. They sued the mineral owners whose rights had purportedly been forfeited, along with those owners' mineral lessees, a group which included SEECO.³⁸

The Van Buren County Circuit Court³⁹ entered summary judgment for the defendants. Like in every other county that I am aware of, Van Buren County's tax assessor never bothered to subjoin⁴⁰ mineral and surface assessments, in spite of numerous cases of the Arkansas Supreme Court⁴¹ which required the subjoinder procedure prior to the effective date of Act No. 961 of 1985⁴² which legislatively removed the subjoinder requirement.

Selrahc and Ms. Peevyhouse argued both that the statutory change which abolished the subjoinder mandate should be applied retroactively and that the

³⁷Which is "Charles," spelled backward.

³⁸Actually, this was their second quiet title effort. The first was comically void for failure to name or notify interested parties on the other side.

³⁹Hon. Rhonda K. Wood.

⁴⁰In this context, "subjoin" means to place the assessment of the severed mineral interest immediately adjacent to the surface assessment of the same lands on the assessor's book.

⁴¹This long line authority began in 1950 with *Sorkin v. Myers*, 216 Ark. 908, 227 S.W.2d 958. The most recent case, prior to *Selrahc*, was *Gilbreath v. Union Bank*, 309 Ark. 360, 830 S.W.2d 854 (2006).

⁴²Now codified as A.C.A. § 26-26-1112.

requirement of subjoinder, though it originated from the Supreme Court was, itself, unconstitutional.⁴³ The Court of Appeals affirmed the trial court in a well-written opinion by Judge Glover. The court said that the issue had been addressed several times by the Supreme Court and that it was without liberty to overrule those decisions. It noted that the “retroactivity” argument was available to the Supreme Court in *Gilbreath v. Union Bank*⁴⁴ and that the Supreme Court had declined to apply the 1985 act retroactively then.

Selrahc and Ms. Peevyhouse have petitioned for review by the Supreme Court. Perhaps **Act No. 421 of 2009**, discussed above, will eventually stop such foolishness.⁴⁵

Not every 2009 Arkansas mineral appellate decision arose in the Shale Play area. Three, at least, did not. One of those, *Reidel v. XTO Energy Inc.*⁴⁶ is a Federal

⁴³This one has never made sense to me. Apparently the claim is that there are ways, other than subjoining, to avoid denying a severed mineral owner due process of law. Thus, the argument goes, for the Supreme Court to prescribe subjoinder and only subjoinder is a legislative usurpation which unconstitutionally violates the constitutional principle of separation of powers. I still don’t understand it. The Supreme Court never told the Legislature that it could not substitute another procedure. Indeed, it invited the Legislature to do just that in another decision, *Dawdy v. Holt*, 281 Ark. 171, 662 S.W.2d 818 (1984).

⁴⁴*Supra*.

⁴⁵The reported case does not tell you the whole story here. It seems that Charles (Selrahc spelled backward) Roye owns another company named Galaxy. When no one else would lease the Roye’s claimed interest, Galaxy stepped up and did so. Galaxy then obtained drilling permits from the Oil and Gas Commission (swearing, “under penalty of perjury,” that it had the right to drill), and from the U.S. Forest Service, and drilled and completed a well in the government’s woods. That well is shut-in and classified as “temporarily abandoned” by order of the Oil and Gas Commission, which was less than amused when it learned the story.

⁴⁶E.D. Ark. No. 4:07 CV00304 (GTE)

District Court case containing the allegation that XTO impermissibly deducted post-production costs from royalty payments. The case was filed as a putative class action. However, Judge Eisele denied the plaintiffs' motion to certify the putative class. Class certification was denied because the claims of the putative class are not sufficiently typical of one another. That typicality is lacking because the putative class members are subject to numerous different forms of oil and gas leases, with varying language within their respective royalty clauses.

Judge Eisele also noted the unsettled state of Arkansas' jurisprudence on the post-production cost issue. Recall that Arkansas has but two reported cases on that issue and that those pass like ships in the night.

In *Clear Creek Oil & Gas Company v. Bushmiaer*,⁴⁷ the court held that when the point of sale occurred downstream from the well, the reasonable cost of transporting the gas to that point was proportionately chargeable to the royalty owner.⁴⁸ However, in the later case of *Hanna Oil & Gas Company v. Taylor*,⁴⁹ the court refused to allow the lessee, Hanna, to deduct the cost of compressing the gas to exceed pipeline pressure, in spite of uncontroverted testimony that there was no market for the uncompressed gas at the well.⁵⁰ Hanna had established a long course of conduct of not deducting compression costs prior to changing its royalty calculation methodology so that they

⁴⁷ 165 Ark. 303, 264 S.W. 830 (1924).

⁴⁸ *Id.* at 303, 264 S.W. at 832.

⁴⁹ 297 Ark. 80, 759 S.W.2d 563 (1988).

⁵⁰ *Id.* at 85, 759 S.W.-2d at 566-67

were deducted.⁵¹ It is unclear whether the court's decision in *Hanna* resulted from that change in Hanna's course of conduct, or whether it was a tacit reversal of *Clear Creek*. Normally, the trend appears to be to base the deductibility of these "post-production" costs upon whether there was, in fact, a market at the well.

One rationale, originating in Oklahoma⁵² and then perverted beyond recognition in Colorado,⁵³ is to tie this issue to the common law implied covenant to market. Thus, we have the "first marketable product rule." The lessee's implied obligations under the lease require the production, free of costs other than taxes, of a marketable product at the mouth of the well. If no such market exists, the reasonable costs of getting to market are deductible. Likewise, if the lessee enhances the value of marketable gas to facilitate a higher price, the additional reasonable cost of doing so is proportionately charged to the royalty share.⁵⁴

Other jurisdictions (Arkansas among them, were it not for *Hanna*) base their determination solely upon the express language of the lease. Thus, a lease form may specify which costs, or no costs, are deductible.⁵⁵ The lease's express language calls for calculation based upon sales at the well. If there are none of those, a calculated sales price is the measure. That price is calculated by taking the first sale, made away

⁵¹ *Id.* at 81, 759 S.W.2d at 564.

⁵² *Mittelstaedt v. Santa Fe Minerals, Inc.*, 903 P.2d 259 (Okla. 1994).

⁵³ *Rogers v. Westerman Farm Co.* 29 P.3d 887 (Colo. 2001).

⁵⁴ *Mittlestaedt, supra*.

⁵⁵ Remember that severance taxes and conservation assessments are charged against all owners, by statute, however.

from the well, and deducting the reasonable cost of getting the gas to that sale point, in salable condition. I am not sure that either of the above rationales makes much difference to the end result. It seems that jurisdictions are either liberal in allowing deduction of post-production costs,⁵⁶ restrictive,⁵⁷ confused⁵⁸ or totally nuts.⁵⁹ Regardless, this is an area quite ripe for con-torsion and, thus, is popular with class action plaintiffs' lawyers.⁶⁰

One of the two non-Arkansas cases demanding attention this year involves this very issue. The North Dakota case of *Bice v. Petro-Hunt, L.L.C.*⁶¹ was a certified class action.⁶² The class sought damages for royalty underpayment alleged to have resulted from improper deduction of post-production costs. The North Dakota Supreme Court affirmed the District Court's summary judgment for the producer, thus placing that jurisdiction in the "at the well"/net-back camp and rejecting the first marketable product approach. Using the Liberal/Restrictive/Confused/Totally Nuts test invented above, count North Dakota liberal.

⁵⁶i.e., Texas.

⁵⁷i.e., Oklahoma.

⁵⁸i.e., Arkansas.

⁵⁹i.e., Colorado.

⁶⁰For a thorough discussion of the state of post-production costs' law see France, Lisa-Marie, **Deciding to Tolerate Ambiguity: *Rogers v. Westerman Farms Co.* and "at the well language" to Determine Royalty Allocation in Oil and Gas Leases**, 56 Ark. Law Rev. 903.

⁶¹768 N.W.2d 496 (N.D. 2009)

⁶²Unlike *Reidel*, *supra*.

All of this, somewhat awkwardly, transitions to our discussion of ***Sutton v. Sutton***,⁶³ the case that is correct in spite of its opinion. Ronald and Bonnie Sutton are the parents of Lonnie Sutton, who was formerly married to Lorene Sutton. While Lonnie and Lorene were married, the four Suttons purchased a farm in Scott County from William and Etta White. The Whites deeded only to Ronald and Bonnie⁶⁴ and reserved a one-half mineral interest.

Then, two years later but before the deed was recorded, Lonnie and Lorene's names were added to the deed by interlineation. Later, almost ten years after originally acquiring the farm, Ronald and Bonnie conveyed it, by warranty deed, to Lonnie.⁶⁵ That warranty deed, which is the principal one involved in the litigation, purports to reserve a one-half mineral interest to the grantors, Ronald and Bonnie. Next Lonnie quit-claimed his interest to Lorene.⁶⁶ According to the Supreme Court's opinion, that "quit-claim deed also reserved fifty percent of the mineral rights," but that was a misstatement of the facts. Actually the "mineral reservation" in the quit-claim deed merely purported to acknowledge the reservation in the warranty deed previously given Lonnie by his parents.

The question before the Court was "who owns the minerals under the farm?" Of course, the Whites own a one-half interest. That is the easy part. What about the

⁶³2009 Ark. 109, ___ S.W.3d ___ (2009).

⁶⁴The reason for that is unexplained.

⁶⁵But not to Lorene.

⁶⁶Possibly the younger couple was getting divorced.

other half? That involves Texas' *Duhig* rule,⁶⁷ as domesticated here in two contrasting Arkansas cases, *Peterson v. Simpson*⁶⁸ and *Hill v. Gilliam*,⁶⁹ which were decided in the same term-of-court, in 1985. *Duhig* requires the subtraction of any outstanding mineral reservation from any new exception or reservation unless the new reservation is clearly and expressly made in addition to the previous one. In Arkansas, *Duhig* applies to warranty deeds⁷⁰ but not to quit-claim deeds.⁷¹ The express purpose of *Duhig*'s application is to provide a bright-line rule of property to relieve innocent purchasers for value of the duty to ascertain the specific intent of previous grantors in warranty deeds. The doctrine applies to warranty deeds but not quit-claim deeds because, in a warranty deed, the warranty trumps inconsistent ambiguous language of reservation or exception. Not so in a quit-claim deed, which has no such warranty.

Thus, according to the Supreme Court, Lorene owns the missing one-half mineral interest. Ronald and Bonnie's "reservation" failed because of *Duhig*. While the Court fails to make this clear, Lonnie's reservation also failed, because it was not really a reservation.

But wait! Who said any of these Suttons were innocent purchasers without notice? They are all kinfolks, sort of. That is the tricky part of my conclusion that the

⁶⁷From *Duhig v. Peavy-Moore Lumber Co.*, 135 Tex. 503, 144 S.W.2d. 878 (1940).

⁶⁸286 Ark. 177, 690 S.W.2d 737 (1985).

⁶⁹284 Ark. 383, 692 S.W.2d 737 (1985).

⁷⁰*Peterson, supra.*

⁷¹*Hill, supra.*

result in the case is correct.⁷² Here is the explanation. *Sutton* was an action to quiet title, brought by Ronald and Bonnie. In a quiet title action a plaintiff must prevail upon the strength of his own title. Ronald and Bonnie should have brought an action for reformation of their warranty deed to conform to the parties' intents.⁷³ Had that occurred, the court would have been squarely presented with the intent issue and likely would never have needed *Duhig* at all.

Arkansas Department of Environmental Quality v. Oil Producers of Arkansas⁷⁴ deserves mention, though its appellate career, so far, has been only interlocutory. Oil Producers sued ADEQ to prevent enforcement of ADEQ's "reserve pit environmental permit" requirement. Oil Producers contend that the permit requirement is an unauthorized regulation which is also an *ultra vires* usurpation of the Oil and Gas Commission's jurisdiction.

ADEQ moved to dismiss, claiming the suit was barred by sovereign immunity.⁷⁵ Bad theory. The case goes on.

The final 2009 case is out of Indiana. It is ***Cimarron Oil Corp. v. Howard***

⁷²Though its opinion is likely to be widely misunderstood.

⁷³They are, after all, almost the same parties. Although Lorene was not a party to the warranty deed she obviously had contemporaneous knowledge of its intent. Indeed, she testified, contrary to her own interest, that she believed Ronald and Bonnie had reserved a mineral interest.

⁷⁴2009 Ark. 297, 285 S.W.3d 654 (2009)

⁷⁵Remember that up to 7% of your income goes, in part, to pay assistant attorneys general to make such inane arguments and support the various state courts whose valuable time is wasted where they are made and, ultimately, rejected. Makes me want to go throw a tea bag into Bayou DeView.

Energy Corp.⁷⁶ We have been keeping score of jurisdictions' rulings on the ownership of coal bed methane gas in controversies between the separate owners of coal and gas under the same lands. We do so because Arkansas, which has coal bed methane production,⁷⁷ has never decided the issue. Score one, tentatively, for the coal guys here. Remember, however, that like Pennsylvania, West Virginia and Kentucky, Indiana is a traditional coal mining state. In those jurisdictions it seems that there are two classes of minerals, coal and everything else.

Well, that wraps up another report. Tune in again next year. There are a lot of cases on their way up, including interpretations of Arkansas' statutory Pugh clause, the Supreme Court's final disposition of *Selrahc*, challenges to eminent domain powers of gathering companies and much, much more. I am going to return to having fun so I can be back in a flash.

⁷⁶909 N.E.2d 1115 (Ind. Ct. App. 2009).

⁷⁷From wells in Sebastian and Scott Counties.

Recent Developments in Natural Resources Law–2010 Update



By Thomas A. Daily



Recent Legislation

- **Act No. 719 of 2009¹** defines the “prudent operator” standard under an oil and gas lease.
 - 1Now codified as A.C.A. § 15-73-207.



Recent Legislation

- **Act No. 1183 of 2009¹** requires that an oil and gas lessor be given notice of the first assignment of his lease, if the assignment occurs within 24 months after the lease's execution.
 - ¹Now codified as A.C.A. § 15-73-208.



Recent Legislation

- **Act No. 421 of 2009¹** is my personal favorite of all of the 2009 Legislature's work. That act sets the ad valorem tax value of a non-producing mineral interest at "zero (0) value." The purpose of this much-needed piece of legislation is to cure an obvious illegality in the ad valorem taxation of mineral interests.
- ¹Now codified as part of A.C.A. § 26-26-1110.



Recent Legislation

- **Act No. 1175 of 2009** was an Oil and Gas Commission sponsored bill which made numerous technical changes to Arkansas' oil and gas statutes. Its most notable sections are Section 1, which clarified that five affirmative votes are required for the Commission to issue an order, and Sections 15 and 17 which amended A.C.A. § 15-72-304 and A.C.A. § 15-74-604, respectively, to permit royalty or other proceeds of production to accumulate up to \$100 before requiring payment.



Recent Legislation

- **Act No. 389 of 2009¹** reduces the qualifying age of an oil and gas commissioner from 30 to 21 and requires that a majority of those² be persons “experienced in development, production or transportation of oil or gas.”
 - 1Amending A.C.A. § 15-71-102 (b).
 - 2The previous version said “four.”



Recent Legislation

- **Act No. 452 of 2009¹** transferred certain authority to enforce the Federal Natural Gas Pipeline Safety Act of 1968 from the Arkansas Public Service Commission to the Oil and Gas Commission.
 - 1Amending A.C.A. § 15-71-110 (d)(18).



Recent Cases

- ***Strohacker Cases:***
 - ***Webco, Inc. et. al. v. Anadarko Petroleum Corporation***
 - ***Usery v. Anadarko Petroleum Corporation***
 - ***Robertson v. Union Pacific Railroad Company***
 - ***Froud v. Anadarko***



Recent Cases

- ***DeSoto Gathering Company v. Smallwood***



Recent Cases

- ***Frein v. Windsor Weeping Mary, LP***



Recent Cases

- **The Lease Draft Cases**
 - ***Falwell v. American Shale Resources, L.L.C.***
 - ***Wade A. Whistle, Attorney in Fact for Margaret Whistle Morris v. David H. Arrington Oil & Gas, Inc.***
 - ***Trenthem v. David H. Arrington Oil & Gas, Inc.***



Recent Cases

- ***Selrahc Limited Partnership v. SEECO, Inc., et. al.***



Recent Cases

- **The Post-Production Costs Cases**
 - *Reidel v. XTO Energy Inc.*
 - *Bice v. Petro-Hunt, L.L.C.*
- It seems that jurisdictions are either liberal in allowing deduction of post-production costs,¹ restrictive,² confused³ or totally nuts.⁴
- *1i.e., Texas.*
- *2i.e., Oklahoma.*
- *3i.e., Arkansas.*
- *4i.e., Colorado.*



Recent Cases

- ***Sutton v. Sutton***



Recent Cases

- ***Arkansas Department of Environmental Quality v. Oil Producers of Arkansas***

Recent Developments in Natural Resources Law– 2010 Update



By Thomas A. Daily